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**COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY**

Investigation by the Department of Telecommunications
and Energy on its own Motion into the Appropriate Pricing,
based upon Total Element Long-Run Incremental Costs,
for Unbundled Network Elements and Combinations
of Unbundled Network Elements, and the Appropriate
Avoided Cost Discount for Verizon New England, Inc.
d/b/a Verizon Massachusetts' Resale Services
in the Commonwealth of Massachusetts

D.T.E. 01-20

REBUTTAL TESTIMONY

of

HARRY GILDEA

on behalf of

**THE UNITED STATES DEPARTMENT OF DEFENSE AND
ALL OTHER FEDERAL EXECUTIVE AGENCIES**

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1 **REBUTTAL TESTIMONY OF HARRY GILDEA**

2 **I. Introduction**

3 Q. What is your name and business address?

4 A. My name is Harry Gildea. My business address is 1220 L Street, N.W.,
5 Suite 410, Washington, D.C. 20005.

6 Q. What is your professional background?

7 A. I have been a consultant for more than 37 years. Since 1972, I have been
8 associated with Snavelly King Majoros O'Connor & Lee, Inc. (formerly Snavelly King and
9 Associates, Inc.). Before then, I was with the Economic Development Administration in the
10 U.S. Department of Commerce, where I was responsible for evaluations of the
11 effectiveness and costs of federal economic development programs. From 1962 to 1969, I
12 was with Peat Marwick Livingston & Company, where I managed the firm's operations
13 research consulting practice in the Washington area. Prior to 1962, I was a research
14 engineer with Sylvania Electric Products, a subsidiary of the General Telephone and
15 Electronics Corporation.

16 Q. What is your educational background?

17 A. I received the degrees of Bachelor of Science in Electrical Engineering and
18 Master of Science in Electrical Engineering from the Massachusetts Institute of Technology
19 in 1958.

20 Q. What is the nature of your work with Snavelly King Majoros O'Connor & Lee,
21 Inc.?

22 A. As a Senior Consultant for the firm, I work with clients in cases before state
23 and federal regulatory agencies involving public utilities. In this capacity, I perform
24 research and analysis on issues in telecommunications policy, regulation, engineering and
25 economics.

26 Q. Has your work concentrated on particular industries?

1 A. Yes. My work has been primarily in the telecommunications field, but I also
2 have participated in gas, electric and water cases, as well as cases concerning the U.S.
3 Postal Service. In my 29 years of experience in the telecommunications industry, I have
4 performed research and analyses concerning nearly all telecommunications services,
5 including local exchange services, message telephone services, private line services,
6 Centrex, telex, video, data, cellular, personal communications, and other services.

7 Q. Have you testified previously in Massachusetts?

8 A. Yes. I have testified in numerous cases before the Department of
9 Telecommunications and Energy ("Department") and its predecessor, the Department of
10 Public Utilities. Most recently, I submitted testimony in D.T.E. 94-185E, concerning pricing
11 issues for interLATA telecommunications services. I also testified in nearly all of the
12 proceedings concerning price cap filings by Verizon New England, Inc. d/b/a Verizon
13 Massachusetts ("Verizon") and its predecessors — Bell Atlantic, NYNEX, and the New
14 England Telephone and Telegraph Co.

15 Q. Have you testified before other regulatory agencies?

16 A. Yes. I have testified as an expert witness before the Federal
17 Communications Commission ("FCC") and the Federal Energy Regulatory Commission,
18 as well as the regulatory agencies of California, Colorado, Connecticut, the District of
19 Columbia, Florida, Georgia, Illinois, Kentucky, Maryland, Michigan, Missouri, New Jersey,
20 New York, North Carolina, Ohio, Pennsylvania, Rhode Island, South Carolina, Tennessee,
21 Texas, and Virginia. In addition to testimony, I have prepared and presented written
22 comments on telecommunications matters to the FCC and many state regulatory agencies.

23 Q. Do you have additional experience in the telecommunications field?

24 A. Yes. I have served as a consultant to federal agencies on rate design and
25 tariff issues in numerous major procurements, including the Aggregated System
26 Procurements for local telephone services in 30 states, the FTS-2000 and FTS-2001
27 systems for intercity telecommunications, the Metropolitan Area Acquisition Program for

1 services to federal offices in many cities throughout the nation, and the Washington
2 Interagency Telecommunications System for services to federal offices in the Washington,
3 D.C. area. Also, I have been a consultant to the Defense Information Systems Agency
4 concerning domestic and international rate structures and services, and the costs of data
5 and voice communications systems.

6 In addition, I have performed damage studies in three antitrust cases
7 involving telecommunications firms. Over the years, I have been engaged as a consultant
8 to telecommunications firms in several proceedings before the Federal Communications
9 Commission, and a case before the United States Court of Appeals. In addition, I have
10 been a consultant to the government of Canada, as well as carriers and end users of
11 telecommunications services in many regulatory proceedings. Also, I testified as an expert
12 witness in a proceeding before the General Services Administration Board of Contract
13 Appeals concerning the award of a major contract for telecommunications services.

14 Q. For whom are you testifying in this case?

15 A. I am testifying on behalf of the customer interests of the United States
16 Department of Defense and All Other Federal Executive Agencies ("FEAs").

17 Q. What is the general subject of your testimony?

18 A. My testimony concerns costing and pricing issues for unbundled network
19 elements ("UNEs") offered by Verizon to its customers. This testimony responds to the
20 testimony and studies filed by both Verizon and AT&T of New England on May 8, 2001.

21 Q. What are the customer interests of the FEAs in this proceeding?

22 A. The FEAs' activities in Massachusetts require telecommunications services
23 and facilities provided by Verizon and other carriers. Since there are many federal offices
24 and installations in the Commonwealth, the FEAs are one of the largest end users of
25 telecommunications services in the state.

26 Q. Do the FEAs obtain UNEs from Verizon?

1 A. No. As end users, the FEAs do not acquire UNEs from incumbent local
2 exchange carriers (“LECs”). However, the prices, terms and conditions for UNEs that
3 incumbent carriers provide to competitive LECs are important to the FEAs because they
4 will determine, in large measure, the prices that end users will pay to acquire services from
5 competitive LECs.

6 Q. Are the issues in this proceeding particularly important to end users who
7 employ a competitive bidding process to obtain telecommunications services?

8 A. Yes. If the newly certificated local exchange carriers cannot obtain the UNEs
9 that they need from Verizon at reasonable prices, there will be few competitive alternatives
10 available to the government or any other users of telecommunications services.

11 **II. Assessment of Cost Studies**

12 Q. What cost models did Verizon submit in this proceeding?

13 A. Verizon’s estimates were developed using costing models including a loop
14 cost model (“LCAM”) and an interoffice transport model.¹ The company also used two
15 models developed by Telecordia Technologies — the Switching Cost Information System
16 (“SCIS”) and the Common Channel Switching Cost Information System (“CCSCIS”).²
17 Moreover, the company employed a spreadsheet building tool called “VCost” and
18 additional Excel spreadsheets.³ Verizon asserts that the studies performed using these
19 models are all based on long-run incremental costs.⁴

20 Q. What cost models does AT&T employ?

1 Panel Testimony of Verizon Massachusetts on Cost and Rates for Unbundled Network Elements
and Related Wholesale Services (“Verizon Panel Testimony”), p. 12.

2 *Id.*

3 *Id.*, pp. 12–15.

4 *Id.*, pp. 15–16.

1 A. AT&T submits an updated version of the HAI Model, Release 5.2 for
2 Massachusetts (“HM 5.2a–MA”), and an adjunct model.⁵ AT&T states that this approach
3 reflects the appropriate long–run incremental methodology for determining the costs that
4 Verizon incurs in providing UNEs in Massachusetts.⁶

5 Q. What is your overall assessment of the two approaches?

6 A. I believe that the HAI approach is preferable.

7 Q. Why?

8 A. First, the HAI approach is a better representation of future conditions, which
9 is the most important consideration in setting rates for the future. Secondly, Verizon’s
10 approach contains specific infirmities that I shall discuss in my testimony.

11 Q. Why do you believe that the HAI approach is a better representation of future
12 conditions?

13 A. The HAI approach is forward–looking and based on solid engineering
14 principles.⁷ Significantly for end users, the approach has evolved to the present version in
15 response to (1) the availability of more data and information; (2) recommendations of the
16 FCC and the Federal–State Joint Board on Universal Service; and (3) comments by
17 intervenors and state regulatory agencies.⁸ In addition, the approach offers flexibility to
18 users, both in control of the inputs and in the operation of the model, as well as in the ability
19 to perform sensitivity analyses.⁹

20 Q. How would you contrast Verizon’s cost studies?

5 Direct Testimony of Robert A. Mercer, p. 5.

6 *Id.*, p. 6.

7 Direct Testimony of John C. Donovan, pp. 5–10.

8 *Id.*, p. 10.

9 Direct Testimony of Robert A. Mercer, p. 6.

1 A. Verizon’s studies are more narrowly defined and based substantially on the
2 historic configuration and design of the company’s local exchange network, as well as
3 factors that reflect historical costs and operating procedures.

4 Q. Why?

5 A. There are several indicators of the retrospective nature of Verizon’s
6 approach. For example, Verizon emphasizes that it eschewed “speculative future
7 innovations” and “changes in wire center locations”.¹⁰ Indeed, the company grudgingly
8 uses total element long–run incremental cost (“TELRIC”) methods at all, emphasizing that
9 the requirement to employ TELRIC is pending review by the U.S. Supreme Court.¹¹
10 Additionally, the company refers to “current actual utilization” and data in its property
11 records for equipment “installed in 1998.”¹²

12 Q. Are there additional indications of Verizon’s inflexibility in this regard?

13 A. Yes. The company is very conservative in estimating costs developed on the
14 basis of material prices. For example, the company states that relationships between
15 material prices and total installed costs based on 1998 data are representative of those
16 that the company expects to experience on a going–forward basis.¹³ Thus, according to
17 Verizon, if the forward–looking incremental costs of equipment are less, an adjustment
18 must be made in the loading factor because the amount of time required to engineer or
19 install the equipment would not change if the price of the equipment itself is reduced.¹⁴
20 The company makes similar statements with respect to maintenance costs and
21 administrative costs such as legal and executive expenses, stating that there is “no reason

10 Verizon Panel Testimony, p. 18.

11 *Id.*, pp. 18–19.

12 *Id.*, p. 30.

13 *Id.*, p. 31

14 *Id.*

1 to believe” that these will decline with reductions in investment costs.¹⁵ I find it especially
2 significant that these assumptions, which appear to assume little or no future improvements
3 in labor productivity, were apparently made without the benefit of any sensitivity analyses.

4 Q. Is there additional evidence that Verizon’s studies look to the past rather than
5 the future?

6 A. Yes. Verizon’s cost estimates are based on figures that the company
7 designates as “proprietary” data.

8 Q. Does the HAI approach have advantages from the standpoint of an analyst
9 not employed by a carrier?

10 A. Yes. The HAI model has practical advantages from the standpoint of an
11 analyst not employed by Verizon. For example, the HAI model is easier to use because
12 the inputs are non-proprietary and thus subject to public scrutiny. Moreover, models using
13 non-proprietary data have important substantive advantages. For example, they can be
14 refined and updated more readily as additional information becomes available.

15 Q. In summary, based on your review of the costing approach employed by
16 Verizon, do you believe that the carrier has presented reasonable estimates of its costs?

17 A. No. Verizon has made assumptions and tilted its cost studies to inflate the
18 purported costs of UNEs. I shall describe several of these infirmities in my testimony.
19 First, I shall address the capital structure assumed by Verizon.

20 **III. Capital Structure**

21 Q. What capital structure does Verizon use in its UNE cost studies?

22 A. Verizon witness James H. Vander Weide states that he uses a “target
23 market value capital structure” containing 25 percent debt and 75 percent equity as a basis
24 for the company’s assumed weighted average cost of capital.¹⁶

¹⁵ *Id.*, p. 60.

¹⁶ Direct Testimony of James H. Vander Weide, p. 48.

1 Q. What is the basis of Verizon's "target" capital structure?

2 A. The company's witness observes that the Department used a market value
3 capital structure containing 23.5 percent debt and 76.5 percent equity in the previous UNE
4 proceeding.¹⁷ He quotes the Department in finding "We agree with Dr. Vander Weide that
5 it would be inconsistent to use forward-looking competitive assumptions in the investment
6 and expense components of a TELRIC study, but historical accounting-based capital
7 structures in the cost of capital component."¹⁸

8 Q Do you believe that a capital structure of 25 percent debt and 75 percent
9 equity should be employed in setting UNE charges?

10 A. No. I do not dispute the fact that the Department adopted a similar structure
11 — indeed, even a somewhat lesser debt ratio — in the previous UNE proceeding.
12 However, I urge the Department to address the matter anew, and adopt what I believe is a
13 more appropriate forward-looking capital structure in the instant proceeding.

14 Q. Why is Verizon's proposed 25 percent debt and 75 percent equity structure
15 not a reasonable forward-looking target?

16 A. If it is a "target" at all, it is so far in the future as to be irrelevant in establishing
17 rates in this proceeding.

18 Q. Why?

19 A. Verizon currently has a structure with far more debt and far less equity.
20 Indeed, the company's annual report for 2000 supports a ratio of 55 percent debt and 45
21 percent equity, because this report shows long term debt of \$42.5 billion and stockholders
22 investment of \$34.6 billion.¹⁹ These figures are consolidated for the company's operations

17 *Id.*, p. 49.

18 *Id.*, citing Department's order in Phase 4 of D.P.U. 96-73/74, 96-75, 96-80/81, 96-83 and 96-94, p. 53.

19 Verizon Communications Annual Report for 2000, p. 33.

1 in four business segments — Domestic Telecommunications, Domestic Wireless,
2 International, and Information Services.²⁰

3 Q. Are there actions that Verizon could take to bring its capital structure more in
4 line with the 25 percent debt – 75 percent equity “target” that it identifies in this case?

5 A. Theoretically yes, but for a company of this size, significant shifts in the
6 capital structure would take a long while to accomplish. To shift its capital structure this
7 much, the company would have to retire many billions of dollars of debt and/or issue many
8 billions of dollars of equity capital.

9 Q. Among the four business segments that Verizon identifies, are there
10 differences with respect to capital structure and return objectives?

11 A. Yes. Among Verizon’s four business segments, the group called Domestic
12 Telecommunications, which contains the activities at issue in this proceeding, should be
13 among the most regulated, least competitive and least “risky” of the four segments. Thus, if
14 the segments were separately financed, I would expect a greater debt-to-equity ratio for
15 the Domestic Telecom segment than for all four segments combined on a consolidated
16 basis. This relationship contradicts Verizon’s claim that a 25 percent debt and 75 percent
17 equity structure should be employed in determining the costs of UNEs.

18 Q. What do you believe is the appropriate forward-looking capital structure?

19 A. The Department should adopt a capital structure of 40 percent debt and 60
20 percent equity. This structure conservatively represents the company’s regulated
21 operations over the next few years.

22 Q. Why?

23 A. A debt ratio of 40 percent is considerably less than the current book value. In
24 addition, Verizon continues to enjoy enormous market power in Massachusetts. Indeed, a
25 report recently released by FCC shows that competitive LECs provided services over a

²⁰ *Id.*, p. 10.

1 mere eight percent of the end-user lines in the Commonwealth in June 2000.²¹ Moreover,
2 Verizon is the only firm that can provide UNEs for access to its own network, which serves
3 the vast majority of homes and businesses in Massachusetts.

4 Q Should the capital structure for this proceeding reflect market values rather
5 than book costs, as Verizon's witness suggests?

6 A. No. I believe it is appropriate to reflect the book values that can be
7 anticipated over the coming years when the rates at issue here are in effect. For example,
8 because of changes in financing policies, the debt ratio may be declining, and it may be
9 appropriate to take this effect into account. Thus, my recommended 40 percent debt ratio
10 is considerably less than the current book value. However, it is not appropriate to use a
11 pure market-based capital structure, particularly considering Verizon's strength in the
12 market.

13 Q. What is the effect of assuming a market-based capital structure?

14 A. The use of a market-based structure understates the debt-to-equity ratio
15 relative to that computed on basis of the company's financial or regulatory books. Thus,
16 since the "cost" of equity is greater than the "cost" of debt, the use of a market-based
17 structure results in far higher return "requirements" for the carrier.

18 Q. Why is the market-based debt-to-equity ratio so much lower than the book
19 debt-to-equity ratio?

20 A The market and book values of the debt are generally about equal to each
21 other. However, the market value of equity is generally far greater than the book value.

22 Q. Why?

23 A. The market value of equity is the discounted future value of the earnings and
24 dividends that investors expect they will receive in the future from the enterprise, including
25 unregulated investments. For many firms, the spread between the market and book values

²¹ Federal Communications Commission, Common Carrier Bureau, Industry Analysis Division,
Local Telephone Competition: Status as of June 30, 2000, released December 4, 2000, p. 1.

1 of equity has been large in recent years when investors have been valuing stocks very
2 highly.

3 Q. Do witnesses for other parties in this case also address the capital structure
4 issue?

5 A. Yes. John Hirshleifer observes, “In traditional rate of return hearings, capital
6 structure is typically presented in terms of book value weights.”²² This witness
7 acknowledges that the capital structure for UNE costs should not be set solely on the basis
8 of the debt and equity on the books of the company.²³ However, he notes that leasing
9 UNEs is less risky than that of other Verizon activities.²⁴

10 Q. What is the effect of using your recommended capital structure on Verizon’s
11 weighted average cost of capital?

12 A. Assuming the cost rates that Dr. Vander Weide recommends — 7.55
13 percent for debt and 14.75 percent for equity — my capital structure leads to a 11.87
14 percent weighted average cost of capital. This contrasts with the 12.95 percent weighted
15 average cost obtained with Dr. Vander Weide’s figures.²⁵

16 Q. Are there additional impacts of Verizon’s use of an incorrect capital
17 structure?

18 A. Yes. The high equity component in Verizon’s capital structure results in a
19 unnecessarily high allowance for income taxes. This allowance for taxes, which the
20 company would not be required to pay, also increases Verizon’s estimated total costs for
21 UNEs.

22 Q. What is the net effect on the alleged costs of UNEs?

22 Direct Testimony of John I. Hirshleifer, p. 35.

23 *Id.*, pp. 35–37.

24 *Id.*, p. 36.

25 Direct Testimony of James H. Vander Weide, p. 53.

1 A. Annual Cost Factors (“ACFs”) for return and income taxes are multiplied by
2 the investment costs to produce the annualized costs, and hence the monthly costs and
3 proposed monthly charges for UNEs.²⁶ Thus, Verizon’s inflated return and income tax
4 liability translates into inflated charges for all UNEs using Verizon’s plant.

5 **IV. Merger with GTE**

6 Q. Are there additional reasons why Verizon’s costs are not accurate
7 representations of future conditions?

8 A. Yes. Verizon’s costs apparently do not reflect any savings to be expected
9 from the pending merger with GTE. I infer this by virtue of the fact that there is no mention
10 of merger savings in the company’s panel testimony.

11 Q. When was the merger consummated?

12 A. On July 3, 2000, stock in the combined company began trading on the New
13 York Stock Exchange, so that the merger was consummated about a year ago, and the
14 combined company should be starting to experience significant savings. Also, media
15 advertising and invoices began to reflect “Verizon branding” in July and August of last year.
16 Indeed, the name “Bell Atlantic” has quickly become extinct.

17 Q. Why do you believe that there will be savings from the merger?

18 A. If there were not substantial anticipated savings, I do not believe the merger
19 would have been authorized by the FCC and state regulators, including this Commission.
20 Other than cost savings, there is little justification for the merger in my view, because the
21 removal of a major diversified telecommunications carrier from the scene will reduce
22 consumer choice.

23 Q. Is there evidence that the savings will be substantial?

24 A. Yes. Verizon has stated that the savings “will result in significant
25 opportunities for cost savings, revenue growth, technological development and other

²⁶ Verizon Panel Testimony, pp. 36–38.

benefits.”²⁷ Indeed, the company states in its 1998 Annual Report that by the third year following completion of the merger, it expects:

- annual expense savings of approximately \$2 billion, with savings generated from operating and procurement synergies, reduced corporate overheads, the migration of long distance traffic onto GTE’s network, and greater efficiency in wireless operations; and
- annual capital synergies of approximately \$500 million through volume purchasing and the elimination of certain capital costs associated with building a data network in our current territory.²⁸

Although these savings and synergies are totals for Verizon’s operations nationwide, some portion is certainly applicable to the company’s operations in Massachusetts.

Q. Do Verizon’s claims support including an allowance for merger-related savings in the costs of UNEs?

A. Yes. The presence of these statements in the company’s annual report virtually mandates an adjustment to reflect anticipated savings.

Q. Why?

A. In reporting to its stockholders, the company has made very positive claims and advanced specific savings estimates with little or no equivocation. If the company is making such unqualified statements to the public, it should be held to the same standard in establishing UNE charges that will determine what the public will pay.

Q. Does the HAI Model reflect savings anticipated with the merger?

A. Yes. Referring to the estimates in Verizon’s 1998 Report that I referenced above, the HAI model reflects a reduction of 3.57 percent in the Corporate Overhead factor.²⁹ I urge the Commission to include at least this modest adjustment in prescribing future charges for UNEs.

²⁷ 1998 Annual Report for Bell Atlantic, Management’s Discussion and Analysis, p. 1.

²⁸ *Id.*

²⁹ Direct Testimony of Robert A. Mercer, p. 29.

1 **V. Wholesale Marketing**

2 Q. Do you address additional issues concerning ACFs that lead to inflated
3 prices for UNEs?

4 A. Yes. I shall address the element that Verizon calls the “wholesale marketing”
5 ACF, which represents the expenses associated with product management, advertising,
6 and customer Interfacing functions.³⁰

7 Q. What is the basis for this ACF?

8 A. Verizon states that the wholesale marketing expenses it associates with
9 UNEs in this proceeding are based upon the Verizon–East’s regional expenses in 1999,
10 adjusted by “avoided” retail costs.³¹ The company’s panel testimony refers to testimony by
11 one of its witnesses in Part B of this proceeding dealing with resale rates.³² Part B of the
12 proceeding has been stayed.

13 Q. Have you reviewed the company’s “avoided cost” presentation?

14 A. Yes. The avoided cost study is contained in the Part G – Factors section of
15 the CD–ROM entitled VZ–MA DTE 01–20, which was provided by Verizon.

16 Q. Do you believe that the study accurately portrays the costs that Verizon will
17 incur in providing UNEs?

18 A. No, I believe that the company is allowing for costs that it will not incur.

19 Q. Why?

20 A. Verizon’s Direct and Indirect Account Summary indicates that the company
21 believes it will not avoid costs contained in most of its accounts.³³ Verizon claims that the
22 only direct costs avoided are for Product Management (6611), Sales (6612), Customer

30 Verizon Panel Testimony, p. 50.

31 *Id.*, p. 51.

32 *Id.*

33 Verizon Study, Tab 1.

1 Services (6623) and Testing (6533).³⁴ Of these four accounts, only the Sales costs are
2 fully avoided, according to Verizon.³⁵

3 Q. What additional direct expenses are avoided for resale?

4 A. The most glaring omission is Product Advertising (6613).³⁶ I believe that
5 Verizon should ascribe no advertising costs to the provision of UNEs.

6 Q. Why?

7 A. Advertising is not necessary for these services because carriers acquiring
8 UNEs are well aware of the only source of supply — Verizon, the incumbent LEC.
9 Advertising to promote attention by the ultimate users, the competitor's customers, should
10 be the responsibility of Verizon's competitors. Indeed, it is likely that any Verizon
11 advertising would be aimed to promote use of Verizon's services, rather than the activities
12 of a competitor. Thus, by including advertising costs in charges to resellers, Verizon is
13 asking other carriers to pay for activities designed to thwart their own interests.

14 Q. Have you identified additional infirmities with Verizon's cost allocation?

15 A. Yes. There are infirmities concerning "indirect" expenses.

16 Q. What are these infirmities?

17 A. The company considers about 43 percent of expenses for General Purpose
18 Computers (6124) and much smaller percentages of Executive (6711) and General and
19 Administrative (6728) to be avoided. However, according to the company, no costs in any
20 of the other indirect accounts would be avoided.

21 Q. Do you believe that the company's proposals concerning avoided indirect
22 expenses are sound?

23 A. No. Apparently, if the General Purpose Computer maintenance function
24 supports Sales (6612), it was considered avoided in the same proportion as Sales, while if

34 *Id.*

35 *Id.*

36 *Id.*

1 the General Purpose Computer maintenance function supports Product Management
2 (6611), it was considered avoided in the same proportion as that activity. This procedure
3 is reasonable, as far as it goes, but Verizon stopped well short of accurately portraying
4 avoided costs.

5 Q. Why?

6 A. The company shows no avoided costs in numerous other indirect accounts,
7 including Land and Buildings (6121), Furniture and Artwork (6122), Office Equipment
8 (6123), Human Resources (6723) and similar accounts. Yet, just as a reduction in sales
9 (or product management activity) leads to a reduction in requirements for general purpose
10 computers, it also leads to reductions in the requirements for buildings, furniture, office
11 equipment and human resource personnel.

12 Q. Are buildings, furniture, office equipment and human resource expenses
13 variable?

14 A. Yes. If there are fewer employees, less office space is necessary. Also,
15 fewer desks and other office facilities are required. Human Resources costs are also
16 variable. The Human Resources account includes expenses for employee
17 communications, benefit administration, employee activity programs, and employee safety
18 programs.³⁷ The size, scope and cost of many of these activities should be less with fewer
19 employees. Indeed, there are savings because of reductions in direct costs, and also
20 savings because of other indirect cost reductions. For example, with reductions in general
21 purpose computers to support the sales effort, there would be reductions in land and
22 buildings for these computers, and human resources requirements for the personnel who
23 maintain them. Verizon's analysis neglects all of these effects, and thus greatly
24 understates the percentage of costs avoided with UNEs.

³⁷ Uniform System of Accounts, Part 32.

1 **VI. House and Riser Cable**

2 Q. Do you have additional points concerning Verizon's cost studies?

3 A. Yes. I would like to address the network element called House and Riser
4 cable.

5 Q. What is House and Riser cable?

6 A. House and Riser refers to cabling within a multi-story building that provides
7 access to the network side of end users' network interfaces from a point of interconnection,
8 typically in the basement of the building. House and Riser includes "vertical" cable up to
9 the individual floors, as well as "horizontal" cable connecting end users with a central
10 termination point on the individual floors.³⁸ House and Riser also includes terminals, as
11 well as associated installation and engineering costs associated with these facilities.³⁹

12 Q. Are Verizon's policies concerning House and Riser cable particularly
13 important to the FEAs?

14 A. Yes. Nearly all federal offices are located in multi-story buildings where
15 House and Riser cable is employed. Thus, when federal agencies acquire services from
16 competitive LECs, the charges that the agencies pay to these carriers will reflect the costs
17 that these carriers in turn pay to Verizon for House and Riser.

18 Q. Does Verizon propose charges for unbundled House and Riser rate
19 elements?

20 A. Yes. There are three recurring rate elements — building access per pair,
21 floor access per pair, and horizontal cable.⁴⁰ In addition, there is a set-up charge to
22 initiate service.⁴¹ For each of these elements, Verizon shows costs that are

38 Verizon Panel Testimony, pp. 123–127.

39 *Id.*

40 Verizon Recurring Cost Summary, p. 2.

41 *Id.*, p. 3.

1 geographically disaggregated for four types of areas — metro, urban, suburban, rural —
2 as well as a statewide average.⁴²

3 Q. Do you believe the House and Riser costs that the company displays
4 accurately reflect the costs that the company will actually incur to provide these facilities?

5 A. No. In the first place, the company's costs for all of the House and Riser rate
6 elements reflect input assumptions, such as the hypothetical target capital structure that I
7 discussed previously, that inflate the costs.⁴³ In addition, the company assumed a 40
8 percent utilization factor, which also inflates its costs.⁴⁴ While this is the same utilization
9 factor that Verizon assumed for the distribution cable in the local loop, it is much less than
10 the 55.2 percent utilization factor Verizon assumed for feeder cable.⁴⁵

11 Q. Do you believe that the 40 percent utilization factor for House and Riser is
12 reasonable?

13 A. No. The overall size and layout of an office or apartment building will
14 generally change very little, so that it should be relatively easy to estimate the total future
15 requirements for wire pairs, and not necessary to provide a great deal of extra plant to
16 allow for growth and churn. Thus, a utilization factor in the range of 60 to 70 percent would
17 seem to be more than adequate. Indeed, if Verizon wishes to conservatively provide for
18 very large additional demands for a long planning horizon, there is the question of
19 reasonably matching costs and revenues. Beyond a certain point, current customers
20 should not be required to fund speculative future income streams.

21 Q. Are there additional factors that lead to unreasonably high costs for Verizon's
22 House and Riser cable?

42 *Id.*, pp. 2–3.

43 House and Riser Elements Cost Study, Subsection 3.1, Assumptions, and House Horizontal Cable Cost Study, Section 3.1, Assumptions.

44 House and Riser Elements Cost Study, Subsection 1.2 Cost Study Methodology; and House Horizontal Cable Cost Study, Subsection 1.3, Cost Study Methodology.

45 Verizon Panel Testimony, p. 82 and p. 87.

1 A. Yes. Verizon apparently assumes unrealistically low labor productivities.
2 From the response to an interrogatory the FEAs propounded, I have a comparison
3 between the House and Riser termination labor costs for AT&T and Verizon.⁴⁶ This
4 comparison shows that because of significant differences in the times required to place
5 terminal blocks, splice, and perform other operations, Verizon's claimed termination labor
6 requirements, expressed in minutes of work, are more than 10 times those of AT&T.⁴⁷

7 Q. What is the impact of this disparity?

8 A. Verizon's cost for horizontal cable and the associated terminations is several
9 times that for AT&T. The interrogatory response shows a monthly cost of \$1.075 per pair
10 using Verizon's assumptions, but only \$0.232 per pair using the conditions in AT&T
11 analysis.⁴⁸

12 **VII. Conclusions**

13 Q. Do you have any final remarks, in summary, to conclude your testimony?

14 A. Yes. As it makes decisions concerning the costs, and ultimately the charges
15 for UNEs, I urge the Commission to consider the market power that Verizon still enjoys in
16 Massachusetts. At least from the perspective of the FEAs, I can say that end users still
17 depend upon regulatory authorities for steps that will promote more competition and lower
18 prices for telecommunications services.

19 Q. Does that conclude your testimony?

20 A. Yes, it does.

46 AT&T Response to DOD/FEA 1-1, Attachment.

47 *Id.*

48 *Id.*